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Director
International Tax Branch
Corporate and International Tax Division
Treasury
Langton Cres
PARKES ACT 2600

***By Email:*** *MNETaxIntegrity@treasury.gov.au*

Dear Sir/Madam

**MULTINATIONAL TAX INTEGRITY AND ENHANCED TAX TRANSPARENCY**

1. Thank you for the opportunity to provide comments to the Treasury's consultation paper titled *Government election commitments: Multinational tax integrity and enhanced tax transparency* ("**Consultation Paper**")

2. Pitcher Partners specialises in advising taxpayers in what is commonly referred to as the middle market. Accordingly, we service many clients that would be impacted by the measures proposed in the Consultation Paper.

3. We support the Government's commitments to uphold the integrity of the tax system with respect to multinational enterprises ("**MNEs**"), including improving tax transparency.

4. However, we are concerned the measures proposed in the Consultation Paper may, if they are not appropriately targeted, have disproportionate adverse impacts on taxpayers in the middle market. In particular, it is common for domestic transactions to be structured in a way that involves debt interests (to be issued to third parties) to ensure such investors do not participate in profits of a project or transaction. We are concerned that the proposals may drive in-substance debt to be structured as equity, resulting in a significant distortion in the form of the interests being issued. We believe that this will give rise to significant complexity in the middle market in cases where there is next to no risk to the revenue.

5. Any reforms adopted by the Government should not affect genuine investment decisions or should not result in capital allocation decisions that become distorted due to the adoption of tax-driven structures.

6. The reforms proposed in Part 1 of the Consultation Paper relating to limiting interest deductions have the potential to significantly affect business decision and the after-tax profits of Australian middle market businesses and will ultimately call into question the feasibility of undertaking various projects (e.g. property developments).

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7. We are also concerned with the potential disproportionate impact of compliance costs that may be imposed on the middle market as a result of any proposed reforms as such business are generally less equipped and less able to bear such costs in comparison to the revenue risks. Our submission includes recommendations to simplify the law in respect of low-risk arrangements with no tax mischief (e.g. exclusions for wholly-domestic arm's length arrangements as an alternative to the arm's length debt test).

8. Our submission focuses on Part 1 of the Consultation Paper (interest limitation rules), in particular the impact on the property sector (including debt financiers and managed funds). We believe that the Government can use this current consultation to also consider other sensible reforms to the thin capitalisation rules to ensure that they are appropriately targeted to minimise base erosion and profit shifting.

9. To this end, we recommend that Treasury forms a working group consisting of representatives from the ATO and the middle market to consider the key impacts on the sector and to provide recommendations targeted at reducing compliance costs and complexity for the middle market. We request that these recommendations be presented to Government for their consideration prior to the drafting of any exposure draft legislation.

10. In relation to Part 2 of the Consultation Paper (relating to intangibles and royalties), we are concerned that the adoption of an overly broad rule denying deductions or imposing withholding tax payments relating to intangible assets (including in relation to embedded royalties) could go beyond addressing MNE tax avoidance and impact genuine commercial arrangements. Generally, we do not observe taxpayers in the middle market entering into arrangements highlighted as being of concern in the Consultation Paper. We believe any measure should be limited and targeted, with appropriate substance-based carveouts and that the better way to deal with arrangements of concern is for the ATO to apply the existing integrity rules, including via strategic litigation with any further reforms undertaken should judicial guidance identify weaknesses in the current law.

11. In relation to Part 3 (tax transparency) we include recommendations to ensure that any such measures do not inappropriately affect middle market entities (e.g. by limiting it to those CbC reporting entities with significant Australian turnover rather than small subsidiaries of global enterprises).

12. Our detailed comments are contained in the Appendix. Our submission does not seek to address every question raised in the Consultation Paper but addresses the key themes contained in each part, from a middle market perspective.

If you would like to discuss any aspect of this submission, please contact either Leo Gouzenfiter on (03) 8612 9674 or me on (03) 8610 5170.

Yours sincerely

A M KOKKINOS
Executive Director

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## APPENDIX – DETAILED COMMENTS

### Part 1 – Interest Limitation

13. The Government's election commitments involve taking measured steps to implement certain OECD proposals and targeted anti-avoidance measures including limiting debt-related deductions by multinationals at 30% of profits. We understand that this to be targeted towards base erosion and profit shifting behaviours and not to discourage genuine investment.

14. Broadly, we support the adoption of a fixed ratio rule at 30% of profits (EBITDA), provided it is supported by an appropriate arm's length debt test, a worldwide or group ratio rule, as well as retention of existing carveouts such as the de minimis, the "90% Australian assets" test and the exclusion for special purpose insolvency remote entities.

15. However, we highlight that there is likely to be little risk to the revenue where there is a middle market group which borrow from Australian resident financiers or where borrowing arrangements are between related party entities in Australia. These groups would be subject to the same level of compliance as a large multinational group in relation to the proposed interest limitation rule. Accordingly, while we support the adoption of the Government's proposal, we highlight that it is critical that the any legislative reforms include appropriate and targeted compliance saving measures especially designed for the middle market.

#### *Fixed ratio rule*

16. We submit that a tax, rather than an accounting, based EBITDA should be easier to comply with and should reduce compliance costs on middle market entities, which may not otherwise prepare general purpose financial statements.

17. However, any fixed ratio should consider appropriate adjustments to tax EBITDA.

    17.1. It is important that certain non-assessable non-exempt ("**NANE**") amounts relating to cross-border transactions are added back. In particular, section 25-90 of the *Income Tax Assessment Act 1997* ("**ITAA97**") provides debt deductions to entities that derive certain NANE amounts. If these NANE amounts were excluded from the tax EBITDA it would undermine the entire purpose of the provision[1].

    17.2. Consideration needs to be given to the impact the provisions would have on trusts, such as the effect of the CGT discount on the taxable or net income of a trust estate. In considering an EBITDA amount, we believe it would be more appropriate to gross-up any net capital gain to the pre-CGT discount amount for this purpose.

    17.3. As trusts are generally not in a structure that is consolidatable for tax purposes, the tax EBITDA should be adjusted appropriately for intra-group transactions but also allow entities to pick up the excess earnings capacity of other group members in a similar manner to the "associate entity excess amount" concept used in the current safe harbour debt amount. We would strongly recommend consideration of a rule that that allows an entity in a Schedule 2F[2] family group

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[1] For example, if the only source of income of an entity were amounts covered by section 25-90, the fixed asset ratio would deny all the interest deductions.

[2] *Income Tax Assessment Act 1936*.

to "donate" its excess amount to another entity in the family group. The highly regulated provisions contained in Schedule 2F would provide significant integrity for the purpose of this proposed rule. We highlight that disproportionately unfair outcomes would occur for such groups if this rule were not considered[3].

17.4. Prior year tax losses should be added back (i.e. not taken into account) when calculating the tax EBITDA. If interest and depreciation (i.e. capital allowance) deductions are intended to be excluded, where these tax deductions give rise to tax losses, it would undermine the tax EBITDA concept if these amounts had the effect of reducing a future year tax EBITDA amount as a deduction for a prior year tax loss. We understand the exclusion of tax losses from EBITDA is consistent with the approach adopted in the UK.

18. In addition to the above issues, we are concerned that there are many entities in the middle market that have volatile earnings, are start-up entities or those that incur significant expenditures prior to making earnings. In such cases, the fixed ratio rule should be supported with a "carry forward" of denied debt deductions rule.

18.1. Property development will be particularly affected as earnings may be deferred until settlement. In many cases, such entities carry out projects in special purpose vehicles. The feasibility of such projects and the decisions of investors to provide equity depend on after-tax returns on investment being made. Such projects are highly leveraged by their nature providing only fixed returns to those providing finance. It is therefore not feasible to simply fund these predominantly with third party equity, which carry with them significant commercial implications as well as stamp duty issues. Interest expenses are one of the most significant costs in such projects and a permanent denial for interest incurred may result in projects not proceeding where such costs cannot be passed on to buyers and renters.

18.2. Entities in the resources sector incur large up-front expenditures (e.g. for the creation of a wind farm). The Government should consider the potential negative impact of reforms on investment in renewables as Australia strives towards a net zero economy if the lack of a carry forward rule affects the after-tax return or jeopardises the economic viability of such projects.

18.3. Consistent with the UK approach, we suggest that there be no time limitation on the carry forward rule of denied interest deductions. This would simplify compliance and avoid the need to tracking denied deductions separately for each year.

18.4. A recent example are certain hybrid mismatch rules which allow for an indefinite time period within which to recoup denied deductions with later year "dual inclusion income" (e.g. sections 832-240 and 832-565 of the ITAA97).

18.5. Further, as the rules in Division 820 of the ITAA97 can apply to entities of any kind, it would not be appropriate for any loss-type testing to apply to denied, but carried forward, deductions. Otherwise, this would add significantly to the complexity and compliance in applying these provisions. For example, we would be concerned if all such entities were required to apply loss testing

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[3] For example, a trust may borrow to invest in subsidiary trusts and materially worse outcomes arise under a fixed ratio rule if a holding trust cannot pick up the excess capacity of a subsidiary trust. Likewise, if there are two discretionary trusts controlled by the same person. Such an outcome would not arise in a corporate group that is able to consolidate and be treated as a single entity.

provisions. Furthermore, there is no existing way to test for continuity of ownership of a partnership. Existing general anti-avoidance rules can already apply to arrangements entered into with the dominant purpose of obtaining a tax deduction for a particular year which would extend to enlivening a previously denied debt deduction under the fixed ratio rule.

19. We also recommend the Government consider a limited "carry forward" rule for excess debt capacity.

    19.1. While this may add some complexity, it may be appropriate to cover situations where an entity has an unexpected or fall in earnings (e.g. due to events like COVID-19) and may ultimately wind-up its activities in the short-term such that it is unable to utilise any denied deductions in later years.

    19.2. For example, an entity may have had an excess capacity for 5 years straight, however, due to unexpected circumstances, there is a fall in the earnings of the entity. A limited carry forward excess rule would ensure that this type of group is not inadvertently impacted by the fixed ratio rule.

    19.3. A five-year limitation consistent with that adopted by the UK may provide an appropriate balance to achieve fair outcomes for such entities and deal with integrity risks such as the creation of debt in previously lower-leveraged entities.

*Exclusions for low-risk arrangements*

20. As we have highlighted earlier, we believe that the proposed "fixed ratio rule" will significantly increase the compliance costs for middle market taxpayers with simple arrangements.

21. For example, assume that a property trust acquires a property funded by bank debt of 50 and equity of 50%. This arrangement would generally not result in the any denials of debt deductions under the current safe harbour debt amount rules. However, where associate-inclusive debt deductions exceed $2 million, it will not be difficult for the fixed ratio rule to apply, especially given that many property trusts are likely to have a low EBITDA in their earlier years. Accordingly, we believe that a significantly larger proportion of entities will fall within the scope of new rules.

22. Accordingly, to complement the proposed reforms to the thin capitalisation regime and the adoption of a fixed ratio rule, we request that the Government adopt appropriate exclusions from the rules to ensure that the measures are appropriately targeted at MNEs and that they do not adversely impact on domestic commercial transactions conducted by middle market taxpayers. We have outlined recommendations for consideration below.

*Increase to the de minimis rule*

23. With increasing interest rates, the fixed ratio provision is likely to adversely impact a significantly higher proportion of projects in the middle market. For example, with an interest rate of 2.5% p.a., the exclusion of $2 million would have provided a safe harbour for entities with average debt of approximately $80 million or less. Should interest rates increase to 5.0% (or higher), this level of gearing would reduce to approximately $40 million or less to remain within the safe harbour.

24. Furthermore, the base de minimis amount ($2 million) has not changed since 2014, which does not appropriately reflect the significant increases in land value and construction costs in the property sector since that time, that would be predominantly funded by debt in any property development project.

25. We therefore recommend that the Government consider making three amendments to the de minimis rule.

    25.1. The first is to adjust the de minimis base amount to an appropriate level (for example increasing the base from $2 million to $4 million).

    25.2. The second is to apply an annual indexation rate. We note that this is the approach taken in the section 250-30 (ITAA97) de minimis thresholds. This would seek to take into account the increase costs of construction in future periods.

    25.3. The third is to link the de minimis debt deduction amount to the applicable base interest rate[4] for income year plus 3 percentage points (indexation rate). The rate on 30 June 2022 was 3.07% and the current rate in September 2022 is 4.0%. An adjustment factor (of 4.0/3.07) would appropriately uplift a $2 million de minis amount to approximately $2.6 million to appropriately taking into account the escalation of the cost of borrowing.

26. The above suggestions would help to reduce the scope of the new provisions applying to middle market taxpayers but are unlikely to reduce the scope of the large MNEs that the measures are ostensibly targeted at.

*Arms-length debt test*

27. Where the entire (or predominantly all) debt of an entity is sourced from arm's length Australian resident lenders there is little to no scope for any tax mischief or risk to Australia's tax base as the lender would be taxable in Australia on the interest earned.

28. The arm's length debt test or worldwide/group ratio rule are highly complex and costly to comply with. Such costs would be disproportionately borne by middle market entities if they need to turn to these other tests in order to claim interest deductions. Unlike a safe harbour debt amount which allows middle market entities structure more easily to ensure the safe harbour is not exceeded (by only taking on certain levels of debt), the fixed ratio rule dependant on earnings is inherently harder to predict and plan for.

29. Further, it is difficult for entities invested in property to change the debt/equity at a later time mix given the potential costs involved (including triggering stamp duty liabilities as well as potential Division 7A issues). More broadly, secured creditors are unlikely to accept the commercial risks associated with holding equity.

30. As such, upon being denied deductions under the fixed ratio rule, many smaller entities may be forced to turn to the arm's length debt test or a group ratio rule.

31. Based on the latest available ATO statistics for the international dealings schedule (for the 2019-20 income year), only 259 entities disclosed an arm's length debt amount (at an average amount of $543 million) and 58 (non-ADI entities) disclosed a worldwide

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[4] The base interest rate is defined as 90-day Bank Accepted Bill rate published by the Reserve Bank. The rate is published by the ATO on a quarterly basis (see https://www.ato.gov.au/Rates/Shortfall-interest-charge-(SIC)-rates/)

gearing amount (at an average amount of $698 million). These alternative tests are therefore in reality only adopted in practice by a limited number of the largest MNEs operating in Australia and not middle market taxpayers.

32. As such, we recommend the Government take the current opportunity in reforming the thin capitalisation rules to provide appropriate carveouts for entities that may otherwise be pushed into relying on alternative tests to the fixed ratio rule. This would also ease the administrative burden on the ATO as it would not be practical for them to administer an arm's length debt test if it is being relied upon by thousands of taxpayers.

33. Our primary recommendation is that a carveout should be provided where all debt of an entity is domestic debt and from arm's length arrangements. Such arrangements present little risk to revenue such that these entities should not be subject to any interest deduction denials.

    33.1. To give effect to this, the existing concept of "subject to Australian income tax" in the hybrid mismatch rules (section 832-125 of the ITAA97) could be adopted. If an entity can establish all, or substantially all (e.g. 90% plus), of their payments giving rise to debt deductions for an income year that are "subject to Australian income tax" (i.e. assessable in the hands of an Australian recipient) then they should be carved out of the fixed ratio rule. This existing concept requires tracing through trusts and partnerships to a non-transparent entity so there this would not result in any risk that payments of interest assessable to an Australian trust or partnership flow through to a non-resident at the lower withholding rate for interest income.

    33.2. While the rule may sound as though it is complex, we highlight that we believe in practice this provision should be relatively simple to apply by a middle market taxpayer. For example, if the taxpayer simply borrows from an Australian major bank, the taxpayer should be able to prove that the interest income is "subject to Australian income tax". To the extent that a managed investment scheme provides funding, the Fund should be able to identify and provide information that its investors are predominantly Australian resident investors.

34. Similarly, the Government should consider legislating carveouts consistent with the ATO's existing compliance approach in PCG 2020/7 for arrangements considered "low risk".

    34.1. For example, refer to paragraph 30 of the PCG for inward investing entities. These arrangements are generally ones which the ATO does not see fit to dedicate compliance resources to and it may be appropriate to provide statutory carveouts for these rather than push entities to comply with the arm's length debt test and incur the necessary costs to do so. To provide the necessary relief to the middle market, such carveouts could only extend to entities that are not significant global entities ("**SGEs**").

35. Lastly, the Government could consider providing further statutory clarification of the term "commercial lending institution" which is a critical element of the arm's length debt test. In the middle market, many construction projects are funded by 'managed investment schemes' and other 'non-bank lenders' that provide debt funding in the form of first and second secured mortgages. This forms a significant part of the lending market. In particular, the term "commercial lending institution" could be expressly defined in the legislation to include entities such as non-bank lenders in the business of money lending. We note that the UK HMRC recognises that funding from mezzanine lenders (with no equity in the borrower) is normally accepted as being at arm's length

for thin capitalisation purposes.[5] This would ensure that third-party commercial arrangements in which the level of gearing, risk and security are all taken into account by investors and financiers alike are not adversely affected by denials of deductions for interest because some of the project is financed by. Otherwise, mezzanine non-bank lenders in the middle market would be placed at a competitive disadvantage under the proposed reforms as compared to financial institutions.

*Application to managed funds*

36. We recommend that the Government should consider the application of the interest limitation rule to managed funds.

37. The rationale underpinning the existing rules in Division 820 of the ITAA97 to total debt (rather than cross-border related-party debt) is that MNEs have the flexibility to take on a certain level of gearing for their group but allocate the debt to entities in higher-taxed jurisdictions and away from low-taxed jurisdictions so as to minimise the group's overall tax liabilities.

38. Such concerns do not exist for widely held managed funds which have groups of unrelated investors for each fund. Further, many funds are established to undertake specific project for which financing is provided by unrelated parties with the level of gearing based on the specific risks and expected returns for the project alone, with no consideration of other associate entities.

39. Many property funds which are predominantly owned by domestic investors may be considered foreign controlled Australian trusts due to the fund manager or trustee itself being foreign controlled.[6] However, this does not give rise to the potential mischief to the rules are targeted towards. The fund manager or trustee has no incentive to allocate excessive gearing to the Australian fund. The opposite is true as the fund manager would generally seek to maximise the profit of the Australian investors so as to maximise its performance fees, which would also be taxable in Australia. Further, the fund manager owes fiduciary duties to the investors and cannot shift profit away (by excessive gearing) that would otherwise flow to such investors so as to benefit some ultimate foreign parent of the fund manager.

40. Accordingly, we recommend that foreign controlled trusts that are managed investment trusts ("**MITs**") (and their wholly-owned subsidiaries) be excluded from the definition of foreign controlled Australian trust under Division 820. Such an approach would provide appropriate outcomes for multi-class AMITs and CCIVs where the sub-funds have a common trustee, manager, or corporate director

41. We note that it may be necessary for MITs to remain subject to the rules where they are outward investors as the relevant risks may exist in such structures.

*Application to financiers*

42. We note that the Consultation Paper proposes that the fixed ratio rule will target 'general entities' only and not financial entities. We agree with this approach on the stated basis that they are inappropriate for net lenders.

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5 https://www.gov.uk/hmrc-internal-manuals/international-manual/intm519070

6 Section 820-790(1)(d) together with section 820-790(2) of the ITAA97 can treat a widely held managed fund as being foreign controlled simply by having a foreign trustee or manager appointed to the managed fund.

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43. We note that many debt financiers that may are not ADIs (and that may not be considered 'financial entities' under the existing rules) may nevertheless be net lenders. Such entities would be adversely impacted by the fixed ratio rules. Such entities may simply be "intermediaries", such that they effectively provide finance for a fee.[7]

44. To achieve appropriate outcomes for such entities, we understand that consistent with the Government's pre-election commitments, the Consultation Paper, and the OECD Report on Action 4, that the fixed ratio rule should only apply to net interest expenses.

45. As such, financiers who borrow and on-lend at a profit should have a nil (or negative) net interest expense and therefore effectively not subject to denial of debt deductions.

*Application and transition*

46. We understand that the Government seeks to implement the fixed ratio rule from 1 July 2023. We recommend the Government clarify that this will be for income years commencing on or after 1 July 2023 such that early balancers will not be subject to the rules from an earlier time (e.g. 1 January 2023) and be given sufficient time to consider the details of legislative changes and arrange their affairs appropriately.

47. We note that OECD's Report on Action 4 considers transitional rules may be appropriate for entities with pre-existing arrangements that would be affected (see paragraphs 194 to 195).

    47.1. Many entities have entered into long-term arrangements well before any announcements to reform the thin capitalisation rules and would be adversely affected as it may not otherwise be possible to change their funding mix (e.g. closed-ended funds established for specific projects pursuant to a product disclosure statement or investor memorandum).

    47.2. We recommend a transitional rule for entities with arrangements that were entered into prior to 5 August 2022 (i.e. the date of the Consultation Paper) that meet certain criteria.

    47.3. A transitional rule could preserve the existing safe harbour debt amount for a limited period of time. There is recent precedent for this where the reforms to the MIT withholding rules which contained a transitional period of seven years for withholding rates on cross-staple income (or fifteen years for economic infrastructure facilities).

    47.4. Alternatively, a transitional rule could apply to arrangements entered into by entities whose adjusted average debt in the most recent year was below the safe harbour debt amount with no substantial increase (e.g. 20%) in its debt deductions in later years in respect of those arrangements, where no variations are made to such arrangements.

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[7] An entity may provide a first secured mortgage by borrowing from an entity at an interest rate and lending the same amount to the ultimate borrower at the same rate plus a small margin. In such cases, the intermediary is simply providing a service for a fee.

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**Part 2 – Payments relating to intangibles and royalties paid to low or no tax jurisdictions**

48. The Consultation paper notes the Government's intention is to target profit shifting and tax avoidance activities. We understand that the Government intends for any measures to be consistent with attracting investment and genuine commercial activities in Australia and not imposing excessive compliance costs for business.

49. Accordingly, any proposal should be nuanced rather than wholesale, aligning more appropriately with the policy intent. Any proposal should be confined to preventing superficial and contrived arrangements such that any measures do not ignore the economic substance of cross-border arrangements.

50. We highlight that businesses incur significant costs to produce, intellectual property and should be entitled to a fair reward and return on that investment. Adopting a broad rule of denying deductions for all royalties and intangible payments (including those that could in some way be seen as relating to embedded royalties) is likely to disincentivise foreign investment and developments being entered into and/or rolled out in Australia.

51. Intellectual property that is developed offshore and brought into Australia provides substantial and critical benefits to the Australian economy and its people (e.g. vaccines, energy production solutions, software, etc). Australia may miss out, or be delayed access to, the benefits of ground-breaking developments if Australia is viewed as a commercially problematic or overly burdensome jurisdiction in which to operate in.

52. A blunt denial of deductions would negatively impact appropriate genuine commercial structures. Therefore, we recommend that such concerns be dealt with under the existing rules such as the diverted profits tax, transfer pricing rules and the integrity rules in tax treaties as mentioned in taxpayer alerts TA 2018/2 and TA 2020/1.

53. Existing laws[8] and guidance[9] are already in place to address the tax implications of shifting assets, risks, and functions in respect of intangibles (i.e. development, enhancement, maintenance, protection, and exploitation activities). These rules are complex, and many have yet to be tested in the courts. Rather than introducing additional laws that further increase complexity, the current rules should be enforced. Only when it is determined that the current laws are insufficient should alternative rules be considered.

54. Australian businesses generally enter into third party royalty agreements to enhance their operations in Australia. These businesses have no control over the location of the intellectual property they license and bear a significant penalty should they not be able to deduct the commercial royalty expense paid. This penalty would reduce their competitiveness and potential business opportunities thereby impacting their contribution to the Australian economy.

55. However, should a new specific measure be adopted we recommend that the taxpayers in scope include SGEs who are part of a group (e.g. a notional listed company group) whose Australian turnover is more than $250 million.

    55.1. Whether or not an entity is an SGE is determined based on its annual global income. Typically, most SGEs in the middle market have a limited presence in

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8 For example, section 815-130 of the ITAA97.

9 For example, Taxation Ruling 2011/1.

Australia, the majority of which are "inbound" SGEs rather than those whose global parent entity is an Australian taxpayer.

55.2. Many such "inbound" SGEs are small and medium business in Australia. For these entities, any royalty or intangible payments are generally not significant and do not present a significant risk of tax base erosion or profit shifting. In particular, Australian entities that operate through trusts generally do not have material payments relating to royalties or intangibles (i.e. such payments are typically borne by the corporate entities in Australian private groups).

56. Regarding the proposed application of any such rule to 'embedded' royalties, we suggest that delineating the proportion of payments made for goods and services into royalty and non-royalty amounts is a subjective and complex process. For middle market entities, the cost of compliance is likely to be prohibitive when compared to minimal potential for tax base erosion. Similarly, administration of delineation would be costly and impractical for the ATO for this market. On this basis, this proposed measure should exclude embedded royalties.

57. The Consultation Paper seeks comments on the definition of 'insufficient tax' or 'low or no tax jurisdictions.

57.1. We suggest that it is appropriate to deal with the risks via the STTR (subject to tax rule) as part of proposed Pillar Two reforms which the Government has committed to.

57.2. Alternatively, the Government should adopt the 9% rate to align with that accepted by the OECD.[10]

57.3. This OECD report states that:

> *the Subject to tax rule (STTR), which prevents companies from avoiding tax on their profit earned in developing countries by making deductible payments such as interest or royalties that benefit from reduced withholding tax rates under tax treaties and which are not taxed (or taxed at a low rate) under the tax laws in the treaty partner.*

57.4. Given that there is no specific announced proposed start date for this measure we suggest the Government wait until the Pillar Two reforms are finalised before adopting any specific reforms relating to royalties and intangibles as it may turn out not to be necessary following the implementation of Pillar Two.

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[10] https://www.oecd.org/tax/beps/brochure-two-pillar-solution-to-address-the-tax-challenges-arising-from-the-digitalisation-of-the-economy-october-2021.pdf

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**Part 3 – Tax transparency**

58. As an overarching comment, we urge the Government to consider whether unilateral measures requiring public disclosure of CbC reports are appropriate. Despite the EU's reporting directive, we suggest it is more appropriate that any such measures are part of a broader G20 or OECD co-ordinated approach. The imposition of public reporting of global information due to legislative requirements imposed in Australia alone (which may only account for a small fraction of the MNE's global business) may be seen as an unnecessary and counterproductive compliance burden that may detract from MNEs intentions to operate and invest in Australia.

59. Additional disclosure requirements imposed on all SGEs and associated compliance costs would disproportionately affect "inbound" SGEs that may otherwise be small and medium business in Australia. Public disclosure of such entities provides little additional value in terms of increased transparency in relation to the Australian tax system.

60. Similar to our comments in Part 2 above, we suggest an Australian turnover requirement for public CbC reporting (e.g. $250 million of Australian turnover which aligns with the current ATO requirement to lodge Reportable Tax Position schedules).

61. We also suggest that any measure should be limited to CbC reporting entities, a separate concept to SGEs that only seeks to impose reporting obligations on a subset of SGEs.

    61.1. It would be inappropriate to impose a requirement to prepare public CbC reports when there is no requirement to provide them to the ATO in the first instance.

    61.2. For example, an Australian subsidiary of fund that is an investment entity may be an SGE but not a CbC reporting entity. It would be impractical for the Australian subsidiary to obtain CbC data of unconnected subsidiaries owned by a common investment entity.

62. CbC reporting entities already produce a variety of reports that are focused on enhancing transparency. Rather than defining a specific format which requires a company to perform additional analysis (with additional costs and resource burden) we recommend providing flexible reporting requirements with minimum reporting obligations.

    62.1. For example, requiring minimum data aligning to OECD CbC reporting data but with the flexibility that allows additional information to be provided to explain the group's tax profile (e.g. those relating to tax attributes such as tax losses and tax offsets).

63. These reports should not be included in the annual financial reports of the Australian entity. Annual financial reports for companies in the middle market captured under the SGE definition generally include data related to the Australian operations only. Adding in a requirement for the inclusion global information is likely to sufficiently increase the time and cost of preparing accounts.

64. We suggest that, to ensure compliance and availability of information to the public, that the Government centralise the publication and manage the lodgement of any tax transparency information.

65. Lastly, we do not agree with any proposal that companies report arrangements to shareholders based on a high-risk rating as contained in an ATO practical compliance guideline. This suggested measure goes beyond the Government's pre-election policy announcements.

 65.1. Further, such a measure is likely to cause confusion to shareholders as a PCG risk-rating does not accurately measure tax risk faced by a company. Rather, they capture the ATO's preferred tax positions and allocation of compliance resources. PCGs do not provide any view as to the application of the tax law. Many "red zones" contained in the PCG are phrased in vague terms and not easy for taxpayers to apply. We believe this is an extra burden on taxpayers that provides little benefit to investors

 65.2. Additionally, the current A-IFRS disclosure requirements already exist to measure tax risks which have been appropriately considered to sufficiently inform shareholders on material tax risks relevant to a company. These requirements already factor in the likelihood of the revenue authority taking a contrary view. As such, specific disclosure of PCG risk zones is likely to add little and confuse, rather than inform, shareholders.